

Statement of Need and Reasonableness:

Items B through G are necessary for implementation of the adjustment to the program operating cost payment rate. The items specify guidelines for the request, evaluation, rate setting, and recoveries.

Item B establishes the information that must be included in a written request for the one-time adjustment. It is necessary and reasonable to document that the deficit cannot be corrected through a special needs rate adjustment so that the one-time adjustment remains the avenue of last resort and other methods of adjustment specifically designed for that purpose are used first. It is necessary and reasonable for evaluation and rate setting purposes to have a copy of the commissioner's order which indicates the number and type of staff that are needed to correct the deficiency, the projected costs and plan for correcting the deficiency, the reasons the facility was unable to meet staff ratios under current or prior rates and information concerning prior and present staff hours and costs. Without this information the interaction between need, resources, and corrective plans will not be established and adherence to the legislative requirement at Minnesota Statutes, section 256B.501, subdivision 2 would not be met. Therefore, rates would not be adjusted because the commissioner would be unable to determine if the additional costs must be incurred for the quality care of residents in efficiently and economically operated facilities.

Item C establishes the method for evaluation of the facility's request. It is necessary and reasonable to establish the criteria so that providers and department staff have clear guidelines. It is reasonable to only allow the reasonable cost of the additional program staff so that state resources are specifically targeted to the direct care of residents. It is reasonable to derive a per diem by allocating the additional costs to the greater of resident days or 85 percent of capacity days because historically based program costs are determined in this same manner prior to establishment of the payment rate. It is reasonable to deduct efficiency incentive payments, amounts attained by reallocating the facility's costs, and the debt reduction allowance not used for debt reduction from the requested amount because it would be inappropriate to pay increased rates to correct a deficiency in the facility's care program when current rates include amounts not related to cost which could be used for those purposes.

Item D is necessary so that the approved rate request can be added to the facility's current rate. This adjustment will take effect on the first day of the month following the commissioner's determination. It is reasonable to use this date because the first of each month starts a new billing cycle.

Item E specifies that the adjustment will be in effect for 12 months and that at the end of this period, a fiscal and program review will be conducted. A 12-month period is a necessary and reasonable time period in which to analyze the cost. The fiscal and program review is a necessary and reasonable way to assure that the additional payments are used as intended. Subitems 1 to 3 detail actions that may result from the review process. It is reasonable to recover amounts paid and to disallow the incurred costs if a facility fails to meet the required staff ratios because this would circumvent the intent of the rate adjustment. Also the desired result of meeting minimum staffing standards for the particular facility would not have been achieved. It is reasonable to recover overpayments that result when actual costs are below the payment level established for the adjustment

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because the increase in rates is designed to be attributable to increases in costs. Therefore, if the actual costs of the additional staff are below the estimated costs projected by the provider, the overpayment must be returned to the Medical Assistance Program. Also, the adjustment is established from a budgeted amount and thus it would be unreasonable for a provider to profit from supplying either less inputs or less expensive inputs than agreed to when the request was granted. It is reasonable to not make retroactive dollar settle-ups to cost when costs exceed payment levels in order to give providers an incentive to accurately budget for cost increases. If this is not done, the facility's request and the commissioner's evaluation of the request become meaningless. The reduced adjustment or continuation of the payment until the September 30 following the end of the reporting period which includes 12 months of the additional costs is a necessary and reasonable method to establish an annualization of the historical base for purposes of establishing the facility's payment rate in future rate years.

Item F specifies the accounting requirements for costs associated with the adjustment. Recording the costs of the additional program staff separately and disallowing those costs until those costs became part of the historical cost base of the facility is a necessary and reasonable method to facilitate the commissioner's fiscal and program review and to avoid duplicate payments for the same service.

Item G limits each facility to one adjustment. It is necessary and reasonable to limit each facility to one adjustment so that ease in administration is maintained and disruptions to the prospective nature of the rate setting process are minimized. Once the adjustment becomes part of the historical cost base of the facility, the regular trending of costs provided for the operating costs will be sufficient to maintain an adequate cost base.

X. DETERMINATION OF THE PROPERTY RELATED PAYMENT RATE - Part 9553.0060

Statement of Need:

Subpart 1 is necessary to inform providers of the method used to calculate depreciation for the purpose of establishing a depreciation allowance under these rule parts.

Depreciation is a method of assigning the acquisition cost of capital assets to the particular periods or products that benefit from the utilization of the assets.

It is necessary to establish a depreciation allowance to compensate providers for the cost of capital assets used by residents during the period of use.

Reasonableness:

It is reasonable to reimburse providers for the cost of capital assets used by residents because the cost of these assets is a necessary cost of providing ICF/MR services. It is reasonable to spread the reimbursement of the cost of these assets over the useful life of the asset to avoid unnecessarily high costs during the year in which major capital assets are acquired and to more accurately allocate the costs to the periods in which services are provided. Calculating depreciation is also a standard practice in the public and private sectors and an integral part of accrual based accounting. Because the assets are of benefit for more than the year of

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acquisition, the cost of the assets is typically allocated over the life of the asset.

Statement of Need:

Item A, subitem 1 is necessary because to calculate depreciation and for general accounting purposes a method to determine the value of the capital assets must be specified.

Reasonableness:

The reasonableness of valuing capital assets at historical cost has its basis in generally accepted accounting principles (GAAP Guide, 1984: p. 11.02). Under GAAP all assets are recorded in the financial statements at the cost of acquisition, i.e., historical cost. Until the asset is sold no increase in value is recognized. The concept of using the cost incurred when the capital asset was first placed in the program is necessary to comply with the Deficit Reduction Act of 1984, section 2314, (DeFRA), which prevents an increase in the cost of an asset due to changes in ownership. This provision essentially prohibits the practice of paying for the same capital assets more than once, since this practice is unduly costly. Since the sale or reorganization of a provider entity generally results in additional depreciation expense without a corresponding increase in care quality or the level of service provided, it is reasonable to disallow that increase in cost.

Statement of Need:

Subitem 2 is necessary to clarify how donated assets are to be valued because there is no cost to the facility. It is reasonable to limit the value assigned to donated assets to the net book value of the donor which takes into consideration the depreciation already accruing to that asset and so that the asset is not depreciated more than once.

Reasonableness:

It is reasonable to use the net book value of the donor as the capital cost for the donee to reflect the depreciation that has already been paid on the asset. Paying for capital assets a second time is not an expense that must be incurred to provide quality care for residents (Minnesota Statutes, section 256B.501, subdivision 2). This provision is also consistent with the objective of DeFRA.

Statement of Need and Reasonableness:

Subitem 3 is necessary to clarify that the provider may not claim depreciation on assets purchased through government appropriation or grant.

On occasion, capital assets are purchased through governmental appropriations and grants which do not require repayment through the operating revenues of the facility. To pay for depreciation on such assets would result in duplicate payment by the taxpayers. It is reasonable to prohibit duplicate payments by the government because these payments are not consistent with cost containment limitations on the amounts of reimbursement for property specified in Minnesota Statutes, section 256B.501, subdivision 3, and would not be a prudent use of limited government funds.

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Statement of Need:

Subitem 4 is necessary to inform providers of the process to be used to claim depreciation for additions and replacements. Increasing the cost of the capital assets by the cost of the additions or replacements is necessary to allow the provider to receive compensation for the cost of that addition or replacement.

Reasonableness:

It is reasonable to capitalize the cost of additions or replacements because these changes increase the capacity or operating efficiency of the facility and under generally accepted accounting principles expenditures that increase the capacity or operating efficiency are capitalized. It is reasonable to revise depreciation charges on the basis of the new book value because this process is consistent with GAAP (GAAP Guide, 1984: p. 11.03). It is reasonable to measure the revision prospectively and account for it in the current and future periods because those are the periods benefited by the addition or replacement and this method of accounting for the cost is consistent with GAAP and integral to the accrual basis of accounting (GAAP Guide, 1984: p. 11.03). Based upon generally accepted accounting principles and in the interest of cost containment, it is reasonable that increased depreciation expense be claimed at the point construction was completed or the capital asset was replaced because no benefit is derived from the addition or replacement until the process has been completed.

Statement of Need:

Subitem 5 is necessary to clarify how the accumulated depreciation on used assets will be determined so that the remaining depreciation to be included in the reimbursement rate can be determined.

Reasonableness:

It is reasonable to use the useful life schedule in Item B., subitem 1., to promote consistency between the way new capital assets and used capital assets are depreciated. Using the same schedule also increases objectivity and makes the rate-setting process less complex. The initial limiting of accumulated depreciation to 50 percent of historical capital cost, is consistent with the one half of useful life limit established in Item B, subitem 2 and is a reasonable way to make sure that the provider is able to receive some depreciation on a used asset to compensate him or her for the cost of that asset.

Statement of Need:

Subitem 6 is necessary to control the amount paid for capital assets and comply with the Deficit Reduction Act of 1984. The increase in the costs of capital assets due to changes in ownership or reorganization would result in duplicate reimbursement for these capital assets.

Reasonableness:

It is reasonable to limit payments so that limited resources are targeted to resident care rather than capital assets. This provision also creates stability in the industry by eliminating the incentive to sell which

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over time results in increased equity. Also, the increasing of the historical capital cost of an asset as the result of a casualty loss would create an incentive to not carry appropriate levels of liability insurance.

In addition, this provision is reasonable because it promotes cost containment as required in Minnesota Statutes, section 256B.501 and prevents duplicate payments for the same asset as addressed by the Deficit Reduction Act of 1984, section 2314. Also, to reimburse for a casualty loss would not promote the efficient and prudent management of capital assets as required in Minnesota Statutes, section 256B.501.

Statement of Need:

Subitem 7 is necessary in order to prevent situations in which the accumulated depreciation allowance paid could exceed the historical cost of the capital asset. This provision is necessary to comply with the Deficit Reduction Act of 1984 and be consistent with other provisions designed to ensure that assets are only paid for once.

Reasonableness:

Depreciation can be defined as reimbursing the cost of an asset. Given this definition, it is reasonable that the depreciation allowance paid not exceed the historical cost of that asset. This is a reasonable way to limit the amount of reimbursement for property as required in Minnesota Statutes, section 256B.501, subdivision 3, while reimbursing providers for costs incurred.

Statement of Need:

Item B establishes the method used to compute depreciation.

Two of the conventions that accountants depend upon to aid in the interpretation of financial information are comparability and consistency. Because there are several methods to compute depreciation, it is necessary to select a specific method and apply it consistently.

Reasonableness:

The Internal Revenue Code ~~also~~ lists the straight-line method as an acceptable method. It is reasonable to use this method because it is widely accepted, easy to compute, and consistent with past reimbursement methods. The use of other methods of depreciation would result in an acceleration of depreciation payments with no benefit accruing to resident care. Also, under the current straight-line method, the depreciation payments exceed the required principal payments in the first several years of the asset's useful life.

Statement of Need:

Subitem 1 is necessary because an estimate of useful life is needed to compute depreciation of a capital asset using the straight-line method. An industry-wide standard is necessary to increase comparability and consistency.

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Reasonableness:

It is reasonable that the lives assigned to the facility's capital assets be as listed in subitem (1) in order that the standard of consistency be maintained with prior reimbursement rules.

Statement of Need:

Subitem 2 establishes the useful life of a used capital asset. As with the case of a new asset, an estimate of useful life is needed for a used capital asset in order to calculate depreciation using the straight-line method.

Reasonableness:

Again this subitem is necessary and reasonable to promote consistency between this rule and prior rules.

Statement of Need:

Subitem 3 establishes the useful life of leasehold improvements. An estimate of the useful life of the leasehold improvement is needed for the computation of depreciation using the straight-line method.

Reasonableness:

It is reasonable to treat leasehold improvements in the same manner as other capital assets because they are owned by the provider and they should be depreciated in the same manner as capital assets owned by other providers.

Statement of Need:

Item C establishes an investment per bed limit on total historical capital costs. Minnesota Statutes, section 256B.501, subdivision 1, directs the commissioner to "establish procedures for determining rates for care of residents of intermediate care facilities for the mentally retarded." In developing the procedures, the commissioner shall include "limits on the amounts of reimbursement for property, general and administration, and new facilities." This provision is necessary to comply with the directive given by the legislature.

Reasonableness:

This provision has been included in reimbursement rules for the ICFs/MR since 1973, Minnesota Rules, parts 9510.0500 to 9510.0890 and 12 MCAR §§ 2.05301 to 2.05315 [Temporary]. Similar provisions have also been included in the nursing home reimbursement rules, Minnesota Rules, parts 9510.0010 to 9510.0486, and Minnesota Rule, parts 9549.0010 to 9549.0080. The table of limits stipulated in subitem 1 is annually adjusted for inflation and provides for a Class A - Class B differential which reflects the different level of property costs associated with each type of bed. It is reasonable public policy to establish this type of limit on capital assets in order to conserve resources and to encourage prudent management of capital assets. The legislature's intent reflected in Minnesota Statutes, section 256B.501, subdivision 3 establishes that limits on property cost are necessary.

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Statement of Need:

Subitem 2 establishes an annual adjustment to the limits in subitem 1. The cost of constructing and buying new buildings and equipment increase the historical cost base of capital assets. Therefore, it is necessary to reflect this increase in the limits which are applied to capital assets. This allows new providers to purchase or construct new facilities at current prices.

Reasonableness:

It is reasonable to adjust the capital asset limits according to the percentage increase in the construction index published by the Bureau of Economic Analysis of the U.S. Department of Commerce because this is a reputable index developed by an outside agency. This index is a good indicator of changes in construction cost which is directly related to the cost of new capital assets. Furthermore, since the same index has been used since 1973 to update the limits, there is consistency of application. The index also includes all code requirements since it is based upon actual new construction costs.

Statement of Need:

Subitem 3 establishes how the costs related to Life Safety Code compliance will be handled. This provision is necessary to enable providers to comply with changes in the Life Safety Code which occur after the facility entered the program. It is necessary to protect the health, safety, and wellbeing of mentally retarded persons as required in the Mental Retardation Protection Act. (Minnesota Statutes, Chapter 252A.) It also promotes stability by enabling the provider to meet the life safety requirements when the investment per bed limits have been reached.

Reasonableness:

This part provides the means by which providers can make the necessary investment in new capital assets to comply with changes in the Life Safety Code. It is reasonable to compensate a provider for these costs because they are necessary to retain their license and for the protection of residents. It is reasonable to allow this adjustment only for the Life Safety Code changes that occur after the facility enters the Medical Assistance Program because changes in the Code are incorporated in the annually adjusted limits.

Statement of Need:

Subitem 4 establishes a method to update a facility's investment per bed limit. This provision is necessary because a provider must replace equipment and upgrade the facility over time and in order to be able to have these costs recognized, it is necessary to update the facility's investment per bed limits. An increase in the per bed limitation is allowed after a facility's first three full reporting years and every three full reporting years thereafter. The amount of the increase is determined by the average of the annual percentage increases in the investment per bed limitation for the current reporting year and the previous three full reporting years.

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Reasonableness:

It is reasonable to allow a periodic increase in the investment per bed limitation of a facility to allow for the replacement of equipment due to wear and tear from operation because these are costs that must be incurred for the quality care of residents. It is also reasonable to recognize that the cost to replace equipment will be higher than the cost of the original equipment due to inflation. Also, since the useful lives of capital assets, exceed this three year period and since these assets generally are not replaced more often than after they have exceeded their useful life, it is reasonable that the update of limits be at least as long as every three years. Additionally, this provision essentially replicates similar provisions in the prior ICF/MR reimbursement rules.

Statement of Need:

Item D establishes procedures to account for gains and losses on the disposal of capital assets. Guidelines are necessary to clarify how to account for capital assets that are retired or disposed of by abandonment or sale.

Reasonableness:

It is reasonable to account for gains and losses on the disposal of capital assets in the computation of allowable costs because essentially any gain or loss represents an over or under payment in depreciation expense paid. Therefore, the amount should be reflected in the computation of future payment rates. To continue to allow depreciation costs for assets that have been retired from service or abandoned would not be a necessary cost and should not be reimbursed.

It is reasonable to limit the amount of the loss in any one reporting year to prevent a distortion of the payment rate. Also any amount which cannot be claimed in the reporting year may be carried forward to future reporting years. Additionally, the treatment of gains and losses in this item employs a similar concept as that employed by the Internal Revenue Service.

Statement of Need:

Item E deals with the funding of depreciation. The provision is necessary to "assure efficient and prudent management of capital assets as required in Minnesota Statutes, section 256B.501, subdivision 3.

Reasonableness:

The funding of depreciation is a reasonable concept used by organizations with a large investment in long-lived fixed assets to accumulate a fund to replace the asset at the end of its useful life and to provide for the time when principal payments on long-term debt exceed depreciation. Many non-profit organizations and also providers who are financed by the Minnesota Housing Finance Agency fund depreciation currently. The concept of funded depreciation is a reasonable method of achieving the objectives of enhancing the financial stability of this industry and encouraging the accumulation of equity. These objectives are supported by legislative requirement in Minnesota Statutes, section 256B.501, subdivision 3 and by the LAC Report (LAC Report, 1983: pp. 56-63.)

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Statement of Need:

Subitem 1 establishes the formula for funding depreciation as a percentage of equity. It is not necessary that all depreciation paid be funded. Therefore, it is necessary to establish the method to determine the amount of depreciation required to be funded. As the percentage of equity increases, the amount of the annual deposit decreases.

Reasonableness:

This is reasonable in light of the fact that one of the objectives is debt retirement. Since interest income earned on unfunded depreciation is not an offset against capital debt interest expense, providers have an incentive for the accumulation of equity since the interest income accumulated on the unfunded depreciation may be used by the provider without restrictions.

Statement of Need:

Subitem 2 describes the investment vehicle for funded depreciation. In line with the overall goal established by the legislature of assuring efficient and prudent management of capital assets, some guidelines for the investment of funded depreciation assets is warranted.

Reasonableness:

Funds which are accumulated for the purpose of replacing capital assets and reducing capital debts should be placed in an investment which is both low risk and liquid. Savings accounts, certificates of deposit, and United States Treasury bills meet these criteria. This is a reasonable requirement since liquidity and integrity of these funds is important to accomplishing the objective of replacing capital assets and reducing capital debt.

Statement of Need:

Subitem 3 describes the uses of funds in the funded depreciation account. In order to fulfill the objectives of a funded depreciation account, the funded depreciation account must be used for making principal payments for the purchase or replacement of capital assets and for payment of capitalized repairs.

Reasonableness:

It is reasonable to limit the uses of the funded depreciation account in order to assure that the facility has adequate resources to meet its future capital needs. This increases the stability of the industry which benefits providers, residents, and taxpayers.

Statement of Need:

Subitem 4 limits the amount of the withdrawals of funded depreciation for the purpose of purchasing capital assets. Some restrictions are necessary to insure that the funded depreciation account contains enough funds to make required principal payments when these payments exceed the annual depreciation allowance.

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Reasonableness:

Since the funded depreciation amount is also used to purchase, replace, or repair capital assets, it is reasonable to allow withdrawals which do not exceed 50 percent of the cumulative amount deposited in the account. This will assure that the provider will have adequate deposits remaining which can be used to make principal payments and sufficient funds to purchase, replace, or repair capital assets.

Statement of Need:

Subitem 5 requires a separate funded depreciation account for each facility. In order for the Department to be assured that the funded depreciation account is properly administered separate accounting is a necessary element. The amounts deposited and withdrawn should relate to the same facility. If providers were permitted to commingle these amounts the purpose of funding depreciation could be circumvented.

Reasonableness:

Requiring a separate funded depreciation account for each facility decreases the likelihood that the furnishings and equipment at one facility will be upgraded at the expense of another facility. Also, it prevents the mixing of assets and provides a complete audit trail for auditing and accounting purposes. For these reasons, subitem 5 is a reasonable requirement.

Statement of Need:

Subitem 6 proposes an income offset on nonallowable withdrawals. To insure compliance with subitem 3 which limits the use of the funded depreciation account, it is necessary to establish a sanction for providers who use these funds for other purposes.

Reasonableness:

Withdrawals from the funded depreciation account which are used for purposes other than those listed in item subitem 3 would have produced interest income had they been left in the fund. Therefore, it is reasonable that interest income earned by those funds before withdrawal be used to reduce the allowable property related costs as a sanction for misuse of these funds. The first in, first out stipulation provides the basis for determining how much interest income is to be offset. This provision is a reasonable method to insure that funds are used appropriately.

Statement of Need:

Subitem 7 establishes the procedure to be followed when a provider fails to deposit the required amount in the funded depreciation account. It is necessary to explain these procedures so that providers and Department staff have clear guidelines if the situation arises.

Reasonableness:

If the amount deposited in the funded depreciation account is less than the amount required, the difference will be assumed to have been applied to reduce debt and interest expense will be reduced accordingly. This is a

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